Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1995

CAJUN ELECTRIC POWER COOPERATIVE, INC.,

Petitioner,

v.

CENTRAL LOUISIANA ELECTRIC COMPANY, INC., UNITED STATES OF AMERICA ON BEHALF OF RURAL UTILITIES SERVICE, DEPARTMENT OF AGRICULTURE, AND TECHE ELECTRIC COOPERATIVE, INC.,

Respondents.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

BRIEF IN OPPOSITION OF RESPONDENTS CENTRAL LOUISIANA ELECTRIC COMPANY, INC. AND TECHE ELECTRIC COOPERATIVE, INC.

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QUESTION PRESENTED

Whether the courts below abused their discretion in determining that this debtor's conflicts of interest, together with a pattern of conduct resolving those conflicts against the interests of the bankruptcy estate, constitute cause for the appointment of a trustee under 11 U.S.C. § 1104(a)(1) and 11 U.S.C. § 1104(a)(2).

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BRIEF IN OPPOSITION OF RESPONDENTS CENTRAL LOUISIANA ELECTRIC COMPANY, INC. AND TECHE ELECTRIC COOPERATIVE, INC.

Central Louisiana Electric Company, Inc. ("CLECO") and Teche Electric Cooperative, Inc. ("Teche"),[1] respectfully represent:

STATUTES INVOLVED

In addition to appointment of a trustee for cause under 11 U.S.C. § 1104(a)(1), § 1104(a)(2) provides in pertinent part that a trustee shall be appointed:

> . . . if such appointment is in the interests of the creditors, any equity security holders, and other interests of the estate,. . . .

STATEMENT OF THE CASE

A. STATEMENT OF FACTS

Cajun Electric Power Cooperative, Inc. ("Cajun") is a hopelessly insolvent electric power generation and transmission cooperative attempting to reorganize in bankruptcy. It is wholly owned by twelve non-profit retail electric distribution cooperatives. These electric distribution cooperatives are owned by their members, who are also consumers. Each electric distribution cooperative has two representatives on Cajun's board of directors. Cajun

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[1] Pursuant to Supreme Court Rule 29.6, CLECO and Teche state that each has no parent or subsidiary company.

has entered into long term all-requirements power contracts with its member cooperatives. Under these contracts, the member cooperatives are required to buy all of their power requirements from Cajun (to the extent of its capacity), and Cajun is obligated to sell the member cooperatives the power they need at Cajun's cost of production. The costs of constructing Cajun's generation and transmission assets were financed by loans from the Rural Utilities Service ("RUS"). At the time Cajun's bankruptcy petition was filed, its obligations to the RUS exceeded four billion dollars.

Actions taken by Cajun's board manifested conflicts of interest unrelated to Cajun's cooperative structure. First, from the end of November 1994 (i.e., the month before Cajun filed for bankruptcy), to the end of March 1995, Cajun let its overdue receivables from its members balloon from four and one-half million dollars to over fifteen and one-half million dollars. Second, several of Cajun's members who are represented on Cajun's board of directors expressed interest in purchasing Cajun's assets as part of the competitive bidding process Cajun was undertaking to develop its reorganization plan. These prospective purchasers/members intended to participate as bidders in an auction they controlled. Third, after Cajun filed for bankruptcy, but before the motion for appointment of a trustee was filed, Cajun's board attempted to restrict access to information from Smith Barney Inc. (the investment banker that Cajun sought to hire to oversee the bidding process for Cajun's assets) to Cajun's board members only. Fourth, against the advice of its own professionals, Cajun's board sought to thwart CLECO (a creditor whom Cajun had already identified as

a potential bidder) from participating in the Smith Barney sales process for its assets.

Cajun's board of directors took other actions inimical to the bankruptcy estate which were related to its cooperative structure. Cajun's rates are regulated by the Louisiana Public Service Commission ("LPSC"). In December 1994, the LPSC ordered a $30 million reduction in Cajun's wholesale power rates, the event which precipitated Cajun's bankruptcy filing. After a contentious board meeting in which a number of directors resigned rather than vote, Cajun's board voted to appeal the rate reduction upon the affirmative vote of only 7 of its 24 directors. Several of the resigning members (all of whom subsequently rejoined the board) cited conflicts of interest over the rate issue in their written reasons for resignation. Cajun also refused to participate, along with the RUS, in litigation concerning the ability of the RUS to pre-empt state regulation of Cajun's rates because the LPSC refused to allow rates for Cajun which would service its debts to the RUS. These two examples of Cajun's conduct clearly demonstrated that its interest in lower rates for its members predominated over its interest in its own solvency.

B. PROCEEDINGS BELOW

The proceedings below are adequately described in the petition. It should be noted, however, that the Fifth Circuit's decision to affirm the district court's appointment, vacate its original opinion, and adopt the reasoning of the dissent, was based on a more careful reading of the

lengthy stipulation of facts submitted by both parties (App. 2a).[2]

SUMMARY OF ARGUMENTS FOR DENYING WRIT

The district court appointed a trustee not merely because it found conflicts of interest inherent in the cooperative structure of Cajun, but because it found that conflicts of interest were affecting Cajun's conduct and were likely to affect its future conduct. Because its decision was fact-specific, the district court's ruling and Fifth Circuit's approval of that ruling do not in any manner create a special rule for the appointment of trustees in cases involving cooperatives. There is no "split in the circuits" on the issue, and the questions petitioners claim to be presented are not. Additionally, since Cajun's conduct was affected by its various conflicts of interest, petitioner's claim that the Fifth Circuit's holding permits the appointment of a trustee in cases involving a "mere presence of a conflict of interest" is inaccurate; the appellate decision holds that the presence of significant conflicts of interest and actions reflecting those conflicts of interest may constitute cause for the appointment of a trustee regardless of the legal structure of the debtor. That holding is nothing more than the application of plainly worded statutes to the facts of the case. Lastly, because the *conduct* of Cajun arose directly from the conflicts of interest with which the district court was concerned, the

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[2] References are made to the appendices attached to Cajun's Petition and cited "(App. ___a)."

district court and the Fifth Circuit reached the correct and proper conclusion: a trustee was necessary to protect the "best interests of the creditors" under § 1104(a)(2) and was justified under § 1104(a)(1).[3]

The district court did not appoint a trustee because of the actions of remote "third parties"; the trustee was appointed because of the actions of Cajun and those of its member/owners which resolved their conflicts of interest in favor of the members/owners and against the interests of the bankruptcy estate. The district court did not fail to consider the application of less intrusive remedies to this case; it considered such remedies and rejected them as inadequate.

There are no compelling reasons for a review of the decisions below by this Court.

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[3] Petitioners curiously argue in a footnote that the appeals court opinion relies solely on § 1104(a)(1) and is silent with respect to subsection (2). Petitioner then assumes away subsection (2). The appeals court did not limit its approval to subsection (1). In its rehearing, the appellate court clearly stated that the district court's appointment was correct:

> After re-reading the stipulation on file in this case, we find the conflicts of interest within the members of the Board of Cajun Electric Power Cooperative *to be such* that the *court below was correct* in the appointment of a trustee, (App. 2a). (emphasis added)

The district court relied on both § 1104(a)(1) and (a)(2). (App. 20a). Thus, both the district court and the court of appeal considered § 1104(a)(2) and its more flexible standard for the appointment of a trustee applicable to this case.

ARGUMENT

I. The district court's appointment of a trustee was based on an analysis of the facts of the case – the conflicts of interest to which this debtor was subject and the actions of this debtor which reflected those conflicts of interest – and, therefore, does not create a special rule for cooperatives in bankruptcy, does not contradict any congressional intent and does not create a circuit split.

The district court did not justify its appointment of a trustee on the sole basis of Cajun's "organizational structure" as a cooperative. In fact, both courts below found that the appointment was warranted based on several instances of questionable conduct on Cajun's part. Not every cooperative in bankruptcy, by virtue of its "structure" would engage in conduct similar to the acts of Cajun. Thus, the appointment had little to do with the inherent structure of cooperatives generally, and had everything to do with the conflicts of interest that were manifested in the specific acts of Cajun. The Fifth Circuit wrote:

> The conflicts present in this case go beyond the "inherent" conflicts under which all healthy cooperatives operate. Presumably, healthy cooperatives *do not fail to collect monies owed by member-customers* or attempt to *deny* member-customers access to information. Nor do members in healthy cooperatives consider strategies which seem designed to *break-up and scavenge the assets of the debtor*. Once cooperative members begin *working at cross-purposes*, to the extent Cajun's members have, the appointment of a

> trustee may be the only effective way to pursue reorganization.

(App. 13a) (emphasis added).

Therefore, the appellate court specifically found that the district court's appointment of a trustee was justified by at least four separate instances of conduct unrelated to the "cooperative structure" of Cajun. The district court also listed several conflicts that arose out of the conduct of Cajun's board members. The district court found that these conflicts included:

> [1] the failure to collect moneys owed by the member cooperatives; [2] failure to allow some members access to information about and to participate in possible sales of the debtor's assets; [3] Cajun's failure to take a position on the preemption issue which was recently decided by the Court; [4] the interest of some members in the purchase of all or part of the debtor's estate, and their apparent desire to be able to purchase the property at the lowest price possible; [5] the conflict which may arise because of the members' interest in purchasing part of the estate in determining whether to accept or reject other offers which may be made . . . .

(App. 19a) (numbers inserted).

Because both courts below found conflicts of interest manifested in various acts of Cajun's board and its directors, petitioner's argument that the appellate court opinion created a special rule for cooperatives in bankruptcy is meritless. The only rule that can be gleaned from the two opinions is the following fact-grounded one: if a cooperative in bankruptcy does as Cajun did – i.e., fails to

collect moneys from its members, becomes fractionalized and some of its constituents seek to make a bid for its assets while denying potential creditor/bidders access to information about possible sales of its assets, and works at cross-purposes in order to benefit its members – a trustee may be appointed under § 1104(a)(1) and § 1104(a)(2). In short, this case is no more than an illustrative and simple application of § 1104(a)(1) and § 1104(a)(2) to certain facts (i.e., Cajun's actions) in this case.[4] Therefore, it does not impact an important matter of public policy or federal law.

Because the appellate court did no more than approve the district court's application of § 1104(a)(1) and § 1104(a)(2) to the facts of this case, no federal goal is contradicted. Moreover, nothing in the Bankruptcy Code, the Rural Electrification Act ("REAct"), or any other statute suggests that electric cooperative debtors (with or without outstanding loans from the RUS) are subject to any different considerations than any other debtor for purposes of determining whether a trustee should be appointed under § 1104(a)(1) or § 1104(a)(2). As the original majority noted about the Bankruptcy Code, "when Congress wanted to create special rules for certain types of businesses, it did so." (App. 11a).

Similarly, nothing in the REAct remotely suggests that debtors with outstanding RUS loans are subject to special rules for when a trustee should be appointed and that such debtors may engage in conduct that under the

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[4] As pointed out by the court of appeals, the district court's appointment of a trustee is, therefore, reviewable only for an abuse of discretion. (App. 9a)

plain language of § 1104(a)(1) and § 1104(a)(2) would warrant the appointment of a trustee for an ordinary corporate debtor. The cooperative preference in the REAct – or the cooperative structure generally – in no way lessens the effect that Cajun's conflicts have on its estate and creditors or immunizes Cajun from the consequences of its actions. The dissent, which was ultimately adopted as the majority opinion, responded to the original incorrect decision as follows:

> The majority also errs in conflating the conflicts "inherent" in any cooperative organization with those "arising from" inherent conflicts. In my opinion, the majority would shield a cooperative from trustee appointment, no matter how egregious its internal conflicts were, so long as the conflicts could be traced back to the cooperative structure.

(App. 13a n.22).

In other words, where "cause" exists, it does not disappear merely because the RUS lent the debtor money or – more generally – because the debtor voluntarily chose to organize itself under one business form instead of another. Here, the acts of Cajun and its directors constituted "cause" for purposes of § 1104(a)(1) and § 1104(a)(2), and a trustee was properly appointed.

Indeed, petitioner admits that not all of the conflicts will necessarily exist in every bankruptcy involving an electric cooperative. In footnote 1 of the petition, petitioner admits that "[t]he courts below also identified other facts which are not as clearly linked to inherent conflicts arising from Cajun's cooperative structure. . . . "

(Petition for Writ of Certiorari ("Petition") at 6 n.1). However, petitioner implies throughout its petition that the appointment was based on the "mere" presence of conflicts of interest "inherent" in the cooperative structure of Cajun. By the petitioner's own admission, the courts did not appoint a trustee because of the mere "structural tensions" present in an electric cooperative.

Petitioner cites this Court's opinion in *C.F.T.C. v. Weintraub*, 471 U.S. 343 (1985) for the proposition that conflicts of interest should be tolerated in bankruptcy. However, conflicts of interest of the sort in this case – actions by the debtor's owners which favor themselves at the expense of the estate or other parties in interest – are simply not the sort of minor and inevitable conflicts that arguably should be permitted.[5] Indeed, petitioners quote an important passage from *Weintraub*: "[I]f a debtor remains in possession . . . the debtor's directors bear essentially the same fiduciary obligation to creditors and shareholders as would the trustee." *Id.* at 355. (Petition at 10). Because a trustee has the duty of being free of conflicts of interest with respect to the sale of property of the estate, under the *Weintraub* language cited by petitioner, so does the debtor in possession.[6] Additionally, by

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[5] CLECO maintains that conflicts of interest of the debtor, inherent or not, can be so profound as to constitute cause for appointment of a trustee and does not waive its right to so argue. However, it does not believe that that question need be addressed in this case by this Court. The actions of Cajun were sufficient cause to justify appointment of the trustee.

[6] Although the cooperative structure does not permit conflict-free possession by the debtor under all of the conflict restrictions imposed on the trustee (*see* 11 U.S.C. §§ 702 and

engaging in acts that favored its members both financially and in the prospective sale of its assets, Cajun's board and its directors inappropriately and grossly tipped the scales to unfairly favor the members *to the detriment of the creditors and other parties in interest*.[7] This sort of action is misconduct that justifies appointment of a trustee regardless of the organizational structure of the debtor. Therefore, the lower court decisions do not contradict any federal goal relating to electric cooperatives.

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703), clearly Cajun was obligated at the very minimum to prevent blatant and avoidable conflicts of interest regarding the information accessibility and bid evaluation. Because it failed to act fairly in the face of such conflicts, the lower courts found cause sufficient to justify appointment of a trustee.

[7] In the typical bankruptcy case, a debtor's shareholders or members have an interest in maximizing the estate's value, so that as high a residual equity interest in the debtor as possible will remain for their benefit after the creditors (who have higher priorities to the estate) are accounted for. Thus, for example, unlike here, members of an electric cooperative debtor whose total debt is well below the total value of its assets retain a strong economic incentive in seeing that the estate's value is maximized. Similarly, members in an agricultural cooperative, where growers join together to sell their crops to outside buyers, should be economically aligned with the cooperative's creditors in seeing that the cooperative sells its crops at the highest possible price. But this case does not fit that typical mold. Absent a miracle, there is no possibility of a residual equity interest for Cajun's members. Its scheduled debt exceeds the scheduled value of its assets by over two billion dollars. With no hope of recovering any equity interest in the bankruptcy estate, the economic interests of Cajun's members are served by lower electric power rates and bargain purchases of Cajun's assets, neither of which necessarily maximizes the value of Cajun's bankruptcy estate.

Petitioners reach to another electric cooperative bankruptcy case, *Matter of Wabash Valley Power Ass'n, Inc.*, 72 F.3d 1305 (7th Cir. 1995), in an attempt to tease out a conflict with the Fifth Circuit's decision in this case. The *Wabash* opinion had nothing to do with appointment of a trustee. Therefore, petitioner must resort to dicta in the *Wabash* opinion in its search for a circuit split. Specifically, petitioner cites several passages from *Wabash* that speak to the nature of an electric cooperative. On appeal in *Wabash* were several objections by the RUS to the confirmation of the plan of reorganization in that case. On appeal in this case, however, was the appointment of a trustee under § 1104(a)(1) and § 1104(a)(2). The Petitioner's only authority for its contention that there is a circuit split is taken out of context from the section of the *Wabash* opinion discussing the absolute priority rule and the requirement thereunder that a plan be "fair and equitable." The actual language petitioner attempts to import into the trustee context was as follows:

> The absolute priority rule is an aspect of the requirement that a plan be "fair and equitable." There is some appearance of unfairness in the Wabash Plan. Wabash's member distribution cooperatives, whose representatives approved the Marble Hill fiasco, emerge from bankruptcy in the driver's seat, still paying low rates, and still not paying off the REA's debt. This outcome, however, is justified, even dictated, by Wabash's cooperative structure. The Members, by controlling Wabash, control their own rates, making it possible for them to be served under

> the 40 year requirements contract, which are, in turn, Wabash's most valuable possession.

Id. at 1318.

That the *Wabash* court found that the cooperative structure affected the value of the plans of reorganization does not conflict with the Fifth Circuit's conclusion that conflicts of interest and a pattern of resolving those conflicts against the interests of the bankruptcy estate justify appointment of a trustee. The *Wabash* opinion is devoid of any reference to the standards that must be applied under § 1104(a)(1) and § 1104(a)(2) to appoint a trustee over a bankrupt cooperative. Indeed, in an earlier decision involving the same bankruptcy proceeding, *Wabash Valley Power v. Rural Electrictrification Admin.*, 903 F.2d 445 (7th Cir. 1990), the Seventh Circuit actually expressed concern that Wabash had been permitted to remain as debtor in possession in light of the conflicts of interest:

> A debtor in bankruptcy is supposed to maximize the value of the estate, which opposition to a rate increase does not. This suit serves the interests of Wabash's members at the expense of the interests of Wabash's creditors. *We are surprised that the bankruptcy judge has allowed Wabash to operate as debtor in possession, when the clash of interests between creditors and its current management is so obvious.*

Id. at 451 (emphasis added).

Additionally, assuming arguendo the "spirit" of *Wabash* may not be reconciled with that of the appellate decision in this case (and that that constitutes a "split" among the circuits on an important issue), the facts of the two are easily distinguished: The appointment of a

trustee in this matter was justified by the conduct of Cajun's board and its directors. Similar facts were not reported in *Wabash*. Therefore, there is no discernible split between the Seventh and Fifth Circuits on the matter of appointment of trustees under § 1104(a)(1) and § 1104(a)(2).

II. The lower courts did not punish Cajun for the "acts of third parties," and the district court did consider measures less intrusive than a trustee.

Petitioner complains that in scrutinizing Cajun's conduct, the courts below have somehow held Cajun responsible for the actions of "third parties." These so-called third parties were Cajun's member/owner/rate payers. While it can be argued that Cajun does not control the actions of its members, there is no argument but that its members controlled Cajun. This is the fundamental source of the intractable conflicts of interest here. The actions of Cajun's board were not those of owners preserving and protecting a bankruptcy estate and attempting to maximize its value. The actions of Cajun's board reflected their interests in lowering Cajun's wholesale power rates to benefit the members in their capacities as rate payers and in minimizing the value of Cajun's assets to benefit them in their capacities as potential purchasers of those assets. It is silly to claim that the conduct of Cajun's member/owners in their individual capacities cannot be used to determine whether cause exists to replace them with a trustee in their capacities as fiduciaries to Cajun's bankruptcy estate. In any event, the courts below did not rely exclusively on the actions of Cajun's member/owners in their individual capacities in

determining that cause existed for the appointment of a trustee. Most of the conduct described by the lower courts was that of Cajun itself.

Petitioner complains that the district court refused to consider the less intrusive remedy of appointment of an examiner in the case. In light of the conflicts of interest and conduct of Cajun, the district court, acknowledging the presumption against the appointment of a trustee, concluded that "[i]f ever there was a need for a trustee in a Chapter 11 case, this is one." (App. 22a) Therefore, it concluded that a trustee was necessary in this case and that an examiner simply would not do.

CONCLUSION

For the reasons set out above, this is not a case worthy of the Court's limited judicial resources and a writ of certiorari should not be issued.

Respectfully submitted,

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